

ERSO expert meeting Credit Enhancement

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Goran Henriksson, SWEDBANK

Credit enhancement an important tool in financial sector development

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Credit enhancements – what is that? (my definition)

Credit enhancements are all methods/action which make it easier to increase access to the formal financial market

- For all population in a country
- For special groups of people
- In special areas
- For special purpose
- Not only financial methods

Different types of credit enhancements

- Equity
- Seed capital
- Guaranties
- Loan on special condition (local currency, Interest rate, amortization, etc)
- Tax relief
- Infra structure investments
- Technical assistance
- Grants (all things you give away on special condition on better terms than in the market)
- Cooperation

Practical use of credit enhancements

- Equity/seed capital – investments in banks/MFI in order to strengthen the capital base (liquidity and/or solvency)
- Loan on special condition (in local currency, long term, special interest rate, normally the loan should be as a substitute for domestic savings)
- Guaranties – reducing risk, make it easier to borrow
- Tax relief - if you make investments in special areas (housing, environment protection, education)
- Infra structure investments – water, roads, sanitary, etc
- Technical assistance - knowledge, experience, best practise
- Cooperation – if you achieve something by cooperation which you could not do alone

Experience from our history

- Savings banks history in Europe
- Housing project in the 40th and 50th – cooperation between workers, local government and companies
- Housing projects in Estonia 90th
- Tax relief for interest paid for housing loans
- Special favourable loans for housing
- Tax relief for investments in equipment which is good for the environment
- Infra structure investments – local government has to a large extend been responsible
- Technical assistance

What is important to remember when using credit enhancements

- All kind of credit enhancement will sooner or later have impact on the market – if you believe in the marker economy, be careful.
- Credit enhancement is a tool to induce/encourage the financial market but there should be a plan for exit
- Local knowledge is essential
- All actions should be adjusted to actual market condition

Credit enhancements impact on the financial market

Level 1 - Be careful

- Equity/seed capital
- Loans
- Guaranties

Level 2 – Normally no problem but understand the impact

- Tax relief
- Infra structure investments

Level 3 – No problem, go ahead

- Technical assistance
- Cooperation

Key factors for success (in the mind of a banker)

- Sustainable financial development starting from the top and goes downwards.
- If you start development in the informal financial sector (MFI) there must be a plan/connection with the existing formal financial sector.
- The market must have interest to develop downward but are facing hinder which make it impossible for the moment. These are the obstacle we should focus on.

